What does it take?

Taming the World of Business Law

by Mark A. Sargent

What skills do business lawyers need? As someone who helps train law students to become business lawyers, I have worried about this question, in part because it is...
hard to answer without sliding into platitudes about hard work and clean living. The question is also worrisome because it begs another, more fundamental question: What do business lawyers do? Until we understand what business lawyers do (and why clients pay them for it) we can’t identify the relevant skills.

We should not be too confident, however, about our ability to explain what business lawyers do, even if we limit our definition of “business lawyer” to transactional lawyers as distinct from litigators. Even so limited, the term “business lawyer” encompasses many different ways of being a lawyer, and many different legal cultures with their own norms and shared expectations.

The differences arise not only from differences in practice area (a bond lawyer vs. a real estate lawyer) but from differences in scope of function (a generalist who is an all-purpose counselor to CEOs and boards vs. a specialist with technical expertise in tax or securities law), practice setting (large firm vs. small firm vs. in-house), and in local legal cultures (Silicon Valley vs. Wall Street). One way to define what business lawyers do and what skills they need, might be to engage in deep description of as many of those legal cultures as possible, treating the question of what business lawyers do as a problem in ethnography.

Is there not, however, something that links the different cultures of business lawyering? In an article in the *Yale Law Journal*, Professor Ronald Gilson of Stanford used the language of finance theory to suggest that business lawyers face a common dilemma in justifying their existence. That dilemma derives from a principle of financial economics known as the Capital Asset Pricing Model, which assumes that assets subject to business transactions will be priced correctly through operation of the market. If that is true, business lawyers can add nothing to the value of the transaction. In fact, their fees would decrease the transaction’s net value. So, Gilson asks, why do transacting parties persist in using lawyers?

A conventional explanation would be that the transactional lawyer is a hired gun, charged with helping the client grab a bigger piece of the transaction pie as the parties bargain over the distribution of gains and losses. Gilson argues, however, that using lawyers in such a way is a zero-sum game, since both sides will use hired guns and neither will increase the value of the transaction as a whole. If business lawyers were only hired guns, it would be rational for transacting parties to agree not to use them.

A more convincing, if partial, explanation of how lawyers add value to transactions is to recognize how they help reduce the costs of compliance with government regulation and thus increase the value of the transaction. A securities lawyer, for example, will increase the value of a securities offering by helping conduct the offering in a way that reduces the risk of regulatory enforcement action or private litigation.

As crucial as the business lawyer’s function as a guide through the regulatory wilderness has become, it is not the only function. It is probably not even the most important function, because many deals are not heavily regulated. The business lawyer’s most important function, Gilson argues, arises from the fact that the Capital Asset Pricing Model is just that—a model. While the model has explanatory power, it depends on assumptions that are almost never fully reflected in the real world. Assets will not necessarily be priced correctly through the bargaining process, for example, when information is expensive, inaccessible or hard to verify, when transacting parties have conflicting expectations about risk and return as well as differing
investment horizons, when the complexity of transactions generates uncertainty about the nature of the bargain, and when such conflicts and uncertainties require costly solutions (such as “transaction costs”).

These inevitable problems produce market failure: The market does not always ensure that assets are priced and exchanged as efficiently as possible. Business lawyers, acting as “transaction cost engineers,” to use Gilson’s phrase, help by bridging conflicts and mitigating uncertainties, and in so doing add value to transactions net of their fees. This compelling explanation of what business lawyers do can be made more concrete by asking how business lawyers do what they do. This question brings us back full circle, because it is a rephrasing of our initial question: What skills do business lawyers need? Let’s begin with the business lawyer’s function as a guide through the wilderness of government regulation. What skills does that function require?

The Ability to Penetrate the Impenetrable.

When I lead my students on their first forced march through Rule 144 or Regulation S-K, their initial reaction is stupefaction, and then rebellion. How could I possibly expect them to read and be responsible for this stuff? I tell them that the ability not only to read and understand such eye-glazing minutiae, but to solve problems with it, is one of the things that separates lawyers from mere mortals, and that they will become real lawyers (and not just persons with a J.D.) when they learn how to penetrate what appears impenetrable to the untutored and faint of heart.

A Sense of Where You Are.

John McPhee once described Bill Bradley’s uncanny ability to make the right move as depending on “a sense of where you are” on the basketball court. This awareness is also crucial to the lawyer playing on the regulatory field. That lawyer must know not only the “law,” but also when the rules are clear or muddy and when the “rules” are merely implicit, informal understandings. The lawyer needs to know the limits of administrative tolerance and the direction from which private litigation is likely to come. The lawyer must understand how far the public policy implicit in a regulatory system constrains the client’s choices, and where it leaves room for innovation. The ability to predict the behavior of regulators and the private enforcers of regulatory prohibitions, and to assess the purpose and strength of regulatory constraints depends as much on the ability to take in the whole picture as a behind-the-back, no-look pass to the corner.

Defining the skills required to be a “transaction cost engineer” is not so straightforward. How do lawyers bridge the gaps created by informational disparities and conflicts in investment goals and perspectives, while reducing the cost of dealing with those problems? Precise answers to that question will vary from deal to deal, but some general observations are possible.

Mountains, Molehills and Knowing the Difference.

Business transactions, like most human interactions, are often thick with ambiguities about desires and intentions. In this murky atmosphere, it can be difficult to discern what is really important. What a lawyer can bring is an aptitude for distinguishing

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